G-002/M-90-630 ORDER GRANTING VARIANCE FOR ONE YEAR

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Darrel L. Peterson	Chair
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner
Patrice M. Vick	Commissioner

In the Matter of a Petition from Northern States Power Company for a Variance to the Purchase Gas Charges, Automatic Adjustment Rule for Recovery of Carrying Costs Associated with Gas Storage Service	ISSUE DATE: April 4, 1991 DOCKET NO. G-002/M-90-630 ORDER GRANTING VARIANCE FOR ONE YEAR

PROCEDURAL HISTORY

On August 28, 1990, Northern States Power Company (NSP or the Company) filed a request for a variance to Minn. Rules, Part 7825.2700, the Purchased Gas Charges, Automatic Adjustment rule. The requested variance, if granted, would allow the Company to include carrying charges on gas storage inventory volumes as a cost in the Company's purchased gas adjustment (PGA).

On January 10, 1991, the Department of Public Service (the Department) filed its Report of Investigation and Recommendation. The Department recommended disapproving the request for variance.

On January 22, 1991, NSP filed reply comments.

On January 29, 1991, the Residential Utilities Division of the Office of Attorney General (RUD-OAG) filed comments recommending approval of the requested variance.

The Department filed reply comments on February 20, 1991.

The matter came before the Commission on March 19, 1991.

FINDINGS AND CONCLUSIONS

Factual Background

Firm Deferred Delivery Storage Service (FDD) is a gas storage service offered by Northern Natural Gas Company (Northern or NNG) and at least two other companies to gas utilities, including NSP. Through the use of FDD, NSP and other local distribution companies (LDCs) are able to buy gas supplies during summer months, when prices are usually low, and utilize the gas during higher-priced winter heating months. The gas may be purchased from the company which holds the storage contract or it may be purchased from other third parties. The gas which is purchased under FDD contract is stored until use in underground facilities such as depleted gas/oil formations, salt domes or aquifers.

Northern charges both reservation fees and receipt charges for its storage service. LDCs pay reservation fees to reserve capacity on Northern's pipeline for use when the gas is withdrawn for distribution. Receipt charges are paid by the LDC to Northern at the time that gas is injected into the storage facility. In previous dockets involving other LDCs than NSP, the Commission has allowed both reservation fees and receipt charges to flow through to customers in monthly PGA adjustments.

In addition to reservation fees and receipt charges, LDCs incur carrying costs when they choose to contract for FDD service. Carrying costs represent the potential earned return on capital which is lost when the money is tied up in storage inventories. Prior to the current docket, no LDC has requested a specific method of recovery for carrying charges associated with firm deferred delivery storage service.

On November 30, 1990, NSP requested the Commission's approval of various changes to its demand entitlements. Among other things, the Company wished to add 67,500 Mcf per day of firm underground storage by contracting with NNG and two other storage providers for FDD service. The Company's request was granted in the Commission's March 26, 1991 Order, In the Matter of Northern States Power Company's Request for Approval of a Change in its Demand Entitlements, Docket No. G-002/M-90-1064. Only in the current docket, however, did the Company raise the question of recovery of carrying charges.

Carrying Costs

Recovery of Carrying Costs

In prior unrelated dockets, the Commission has previously explored the issue of contract storage service, and has found that such service is of benefit to Minnesota consumers. The wise use of FDD in a gas supply portfolio can result in lower prices and greater flexibility and reliability of gas supply.

The price differential between summer and winter supplies is an obvious advantage of contract storage service. In addition, the increased gas purchases during summer give LDCs greater price leverage with gas suppliers. FDD is also a cost-effective means of meeting weather-driven load swings. Gas storage enables LDCs to shop a wide "spot" market in the summer and purchase supplies which will be reliably available at the necessary time.

Because the use of FDD can bring lower costs and greater reliability and flexibility of gas supply, the Commission will as a matter of policy encourage well-designed programs which provide incentives for FDD use. Allowing the LDC to recover carrying costs associated with the use of contract storage service would be part of such a plan.

There is precedent for the recovery by LDCs of various carrying costs. In general, carrying costs on inventory are recoverable operating expenses in a rate case. NSP has been allowed to recover its carrying costs on liquified natural gas inventories that it uses for peak shaving. In addition, electric utilities are allowed to recover carrying costs on the coal they store and burn to generate electricity.

Because public policy calls for the recovery of carrying charges associated with FDD, and there is precedent for such an allowance, the Commission finds that it is in the public interest to allow this recovery. The Commission notes that at the March 19 meeting, all parties agreed to the principle of recovery of carrying charges.

Direct Cost of Gas

If carrying charges for FDD are to be recovered by NSP, a question remains regarding the method of recovery. NSP argued for recovery through the PGA adjustment. The Department urged the Commission to allow recovery only in a general rate proceeding. In order to decide this question, the Commission must first decide if carrying costs are a direct cost of the purchase of gas.

Minn. Stat. § 216B.16, subd. 7 establishes three types of costs for which the Commission may allow automatic adjustment of charges:

> **Energy cost adjustments.** Notwithstanding any other provision of this chapter, the commission may permit a public utility to file rate schedules containing provisions for the automatic adjustment of charges for public utility service in direct relation to changes in: (1) federally regulated wholesale rates for energy delivered through interstate facilities; (2) direct costs for natural gas delivered; or (3) costs for fuel used in generation of electricity or the manufacture of gas.

If recovery of FDD carrying charges through the PGA is to be considered as an option by the Commission, then, such charges must be a direct cost of the purchase of gas.

The Commission finds that carrying costs associated with gas storage inventories are a direct cost of providing natural gas. Money paid as interest to a supplier for financing the purchase of storage gas is a direct cost of the purchase of gas. In like manner, if NSP chooses to finance storage gas through other means, such as with its own capital, the carrying charges associated with the use of the capital are a direct cost of the purchase of gas.

The Commission notes that all parties at the March 19 hearing agreed that carrying costs of firm delivered storage service are a direct cost of the purchase of gas.

Recovery through Rates or the PGA

Since carrying costs are a direct cost of gas purchase, the Commission has the discretion to allow recovery either through rates or the PGA. If the recovery were allowed through rates, representative amounts would be determined in the test year and the carrying charge applied to determine recovery. As with other non-gas costs, utilities would be at risk for underrecovery between general rate proceedings. If the recovery were allowed through the PGA, a monthly adjustment would be applied to reflect carrying costs accurately.

The Commission agrees with the RUD-OAG that it is in the best interest of the public to allow recovery through the PGA. The utility which recovered its storage carrying costs through base rates would always have an incentive to lessen its purchases of contract storage service, in order to minimize the possibility of underrecovery. Recovery through the PGA would remove this disincentive for the use of FDD, thus benefiting the ratepayer.

Recovery through the PGA is currently allowed for carrying costs included in the unbundled cost of gas from a supplier who combines the gas sales and storage functions. It is therefore logical to allow NSP to recover through the PGA when the Company is in effect financing the cost of storage itself.

In the case of FDD, price differentials and availability of storage vary widely and are difficult to forecast. This variability lends itself better to recovery through monthly PGA adjustments than through rate proceedings.

The Commission disagrees with the Department's argument that including FDD carrying charges in the PGA adjustment will lead to inclusion of every cost associated with gas purchase. Storage carrying charges are a direct cost of gas purchase. Anything which is not a direct cost is not and will not be recoverable in the PGA adjustment. Utilities should note that the Commission's allowance of PGA recovery of FDD carrying costs does not signal a trend towards widening PGA recovery.

The Commission notes that issues of contract storage carrying costs, along with other Company gas purchasing decisions, will be reviewed in the ongoing Department review of utility gas purchasing practices for prudence. This oversight will provide the Commission with a means of monitoring the inclusion of storage carrying costs in the PGA. If the Commission finds that this means of recovery does not lead to prudent decisions on the part of NSP, the variance allowing PGA recovery will not be renewed.

Carrying Charges Set at Prime Rate

In its petition, NSP asked to recover carrying charges set at the prime rate of interest. Based upon Minn. Rule, Part 7825.3100, carrying charges set at the prime rate of interest would be set at the average prime interest rate, the average of the daily prime lending rates offered to preferred customers at the largest bank in the Ninth Federal Reserve District during the month preceding the month in which carrying charges were incurred. The largest bank is that bank with the greatest total outstanding deposits as of the end of the calendar year preceding the year in which carrying charges are set.

The Variance

Minn. Rules, Part 7830.4400 provides that a variance may be granted if the following criteria are met:

1. Enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule;

2. Granting of the variance would not adversely affect the public interest;

3. Granting of the variance would not conflict with the standards imposed by law.

In this case, enforcement of the rule would impose an excessive burden upon the applicant. If NSP implements contract storage with NNG, the Company will incur approximately $170,000 in carrying charges. At the same time, ratepayers will enjoy approximately $600,000 in net savings from the Company's use of FDD. The Commission finds that it is just and reasonable to provide NSP with a means of recovering the carrying costs through the PGA. The Company should not be required to absorb these expenses in order to provide the benefits of contract storage to ratepayers.

Granting the variance would not adversely affect the public interest. Ratepayers would instead benefit from the greater flexibility and reliability of supply NSP would be able to achieve.

Granting the variance would not conflict with standards imposed by law.

The Commission finds that the criteria of the variance rule have been met in this case and the variance may be granted.

Conclusion

Carrying costs of contract gas storage are a direct cost of providing gas to ratepayers. It is reasonable and just to allow utility recovery of this expense. Allowing recovery through the PGA is within the statutory intent of the PGA. Since firm contract storage is a benefit to ratepayers, PGA recovery of carrying costs is a proper incentive for LDCs to enter into such contracts. The Commission will allow NSP to recover carrying costs associated with firm deferred delivery contracts through NSP's monthly PGA.

ORDER

1. Northern States Power Company is granted a one year variance from Minn. Rules, Part 7824.2700, to allow the Company to recover carrying charges associated with contract underground gas storage through the Company's PGA. Carrying charges shall be set at the prime rate of interest as set out in the body of this Order.

2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)